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Before the
FEDERAL COMMUNICATIONS COMMISSION
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In re

Implementation of Sections of
the Cable Television Consumer
Protection and Competition Act
of 1992

Rate Regulation

MM Docket 92-266

TO: The Commission

**CORNING INCORPORATED AND SCIENTIFIC-ATLANTA, INC.
REPLY TO OPPOSITIONS TO PETITION FOR RECONSIDERATION**

Corning Incorporated ("Corning") and Scientific-Atlanta, Inc. ("Scientific-Atlanta"), by their attorneys and pursuant to Sections 1.429 and 1.4(h) of the Commission's Rules, hereby reply to oppositions to their petition for reconsideration of the Report and Order in MM Docket 92-266 (released May 3, 1993), implementing the rate regulation sections of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"). The importance and appropriateness of revising the benchmark/price cap mechanism to ensure full recovery of the costs of cable system upgrades or rebuilds, as Corning and Scientific-Atlanta have urged,¹ has become only more clear in the course of this reconsideration proceeding.² As described below, this capital

¹ Petition for Reconsideration of Corning Incorporated and Scientific-Atlanta, Inc., MM Docket 92-266 (filed June 21, 1993) ("Corning/Scientific-Atlanta Petition").

² Numerous petitioners have confirmed the need for modification of the benchmark/price cap rules to permit the (continued..)

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investment could be recovered not only in the streamlined cost-of-service showing the Commission has proposed, but also by a relatively simple adjustment to the benchmark/price cap mechanism to finance the cost of system upgrades to improve regulated cable service.

The Commission itself has now reaffirmed its fundamental commitment to fashioning a rate regulation regime that recognizes rather than thwarts cable's vital role in our nation's communications infrastructure. Explicit among the regulatory goals of the recently released NPRM in the cost-of-service branch of this proceeding was the tentative conclusion that:

[O]ur regulatory requirements for cost-based rates should also be designed to assure that cable operators may fully respond to incentives to provide a modern communications infrastructure and to respond to competitive forces.³

²(...continued)

ready recovery of investment in system improvements. See e.g., Petition for Reconsideration of Cablevision Systems Corporation (filed June 21, 1993) at 22-24; Petition for Reconsideration of Booth American Company, et al. (June 21, 1993) at 13-15; Petition for Reconsideration of Continental Cablevision, Inc. (June 21, 1993) at 8; Petition for Reconsideration of Discovery Communications, Inc. (June 21, 1993) at 3-5; Petition for Reconsideration and Clarification of Viacom International Inc. (June 21, 1993) ("Viacom Petition") at 4-10; Comments of the Medium-Sized Operators Group (July 21, 1993) at 3 and appendix at 1-3; Joint Opposition of Advanced Communications, Inc., et al. (July 21, 1993) at 9-10.

³ Notice of Proposed Rulemaking in Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket 93-215 (released July 16, 1993) ("Cost-of-Service NPRM") at ¶ 9.

The Commission is surely no less committed to this goal when it comes to crafting the benchmark/price cap mechanism it intends to serve as its primary mode of cable rate regulation.⁴ Yet the primacy of this mechanism faces no more certain threat than that of its failure to permit the recovery of capital investment in upgrades to improve regulated cable service.

That the benchmark/price cap mechanism, as revealed to date, would fail to permit the full recovery of capital investment in such upgrades is not seriously refuted. Opposing telephone companies,⁵ along with NATOA in this instance,⁶ assert that cable operators should have no problem funding the massive capital

⁴ Indeed, Commissioner Barrett has made clear that this goal is critical both to "refin[ing] our rate benchmarks and develop[ing] reasonable cost-of-service rules." Commissioner Andrew C. Barrett, Keynote Address at the Prentice Hall Law & Business 1993 Cable Conference (June 28, 1993) ("Barrett Address") at 5. Noting that the "cable industry represents significant infrastructure investment," Commissioner Barrett expressed his "concern[]" that the Commission's cable regulations . . . not unnecessarily restrict cable from being a leader in the development of this information system." Id. at 3-4.

⁵ The opposition to Corning and Scientific-Atlanta's proposal to provide the means for continued capital investment by cable operators comes (with but one exception) from the telephone industry. See, in MM Docket 92-266, United States Telephone Association Opposition (filed July 21, 1993); Opposition of GTE Service Corporation (July 21, 1993) ("GTE Opposition"); Comments of BellSouth Telecommunications, Inc. on Petitions for Reconsideration (July 21, 1993) ("BellSouth Opposition"); and Opposition of the Bell Atlantic Telephone Companies (July 21, 1993) (collectively "Opposing Telephone Companies").

⁶ Opposition of the National Association of Telecommunications Officers and Advisors, et al., MM Docket 92-266 (filed July 21, 1993) ("NATOA Opposition").

expenditures inherent in system upgrades or expansions based solely on the benchmark/price cap approach as adopted.⁷ Yet they provide no support for their implicit assumptions, first, that cable capital budgets will somehow be unaffected by the typical 10 percent rollback in service rates and even greater rollback in equipment revenues and, second, that the anomalous system rates from which benchmarks were derived would provide adequate revenue not just for ordinary capital expenditures but also for the extraordinary outlays required for significant system upgrades to accommodate must-carry obligations and improve regulated cable service.⁸

Indeed, the substantial record evidence to the contrary remains virtually un rebutted. No party has challenged the Deloitte & Touche analysis demonstrating that capital investment is in fact the most likely victim of the benchmark/price cap mechanism's squeeze on cash flow, which is of course the determinant of both

⁷ Despite its objections to a general pass-through for the costs of system upgrades, GTE would support a pass-through of the costs of franchise-required upgrades. See GTE Opposition at 14 n.34. This interpretation of the already established pass-through for the costs of franchise requirements, while of limited benefit, is certainly warranted. See Corning/Scientific-Atlanta Petition at 20 n.39.

⁸ Despite the subsequent cost savings typically produced by the deployment of optical fiber and related advanced technology, cable operators simply cannot absorb the substantial capital outlays necessary upfront for system upgrades to improve regulated service without adequate cash flow or available financing. See, e.g., Corning/Scientific-Atlanta Petition at 8-14.

system revenues and access to capital.⁹ Nor has any party refuted, for example, the Dertouzos & Wildman study demonstrating that the benchmark/price cap mechanism would produce rates that fail to cover even ordinary costs for many systems because of underlying flaws in the benchmark methodology.¹⁰ In fact, these analyses merit only greater credence in light of such compelling evidence as the joint letter of leading cable industry lenders, which confirms the disincentives for system expansion created not just by present regulatory uncertainty, but also by the substance of the benchmark approach itself.¹¹

Since adoption of the Report and Order in this proceeding, moreover, each of the Commissioners has publicly acknowledged the benchmark/price cap mechanism's potential for serious unintended consequences in this regard. As noted above, the importance of refining the benchmark approach to avoid stifling cable infrastructure investment was a central theme in a recent address

⁹ See Deloitte & Touche, Estimated Impact of Cable Rate Re-Regulation on Cable Television Cash Flows and Capital Expenditures (June 1993) at 4-6, appended to Corning/Scientific-Atlanta Petition.

¹⁰ See J. Dertouzos & S. Wildman, Regulatory Benchmarks for Cable Rates: A Review of the FCC Methodology (June 21, 1993) at 8, appended to Viacom Petition.

The Commission's recent NPRM, moreover, proposes to exacerbate the shortfall between benchmarks and actual costs by cutting back even on the allowed annual inflation adjustment by some putative measure of offsetting productivity gains. Cost-of-Service NPRM at ¶¶ 83-85.

¹¹ See Joint Letter of Commercial Banks, MM Docket 92-266 (filed June 21, 1993).

by Commissioner Barrett.¹² Likewise, in approving the Cost-of-Service NPRM, Commissioner Duggan pointedly expressed his concern "that we not unwittingly create disincentives to upgrade systems or to create new program choices for viewers."¹³ Chairman Quello, meanwhile, has strongly endorsed remedying the disproportionate impact of these regulations on smaller cable systems¹⁴ -- systems citing as "particularly acute" the effect of benchmarks on their ability to finance system rebuilds.¹⁵

To that end, Corning and Scientific-Atlanta have continued to explore how their proposal for external treatment of the costs of investment in system improvements might best be adapted to the rate regulation structure the Commission has already labored hard to construct.¹⁶ This task has been complicated, however, by the

¹² See note 3 supra.

¹³ Comments of Commissioner Ervin S. Duggan, Federal Communications Commission Meeting (July 15, 1993).

¹⁴ See, e.g., Chairman James H. Quello, Remarks Before the 42nd Annual Convention of the National Cable Television Association (June 8, 1993).

¹⁵ See Petition for Reconsideration of the Community Antenna Television Association, Inc., MM Docket 92-266 (filed June 21, 1993) at 4-5, 9. See also Barrett Address at 4-5 (the agency "must avoid an unintended result whereby larger, vertically integrated cable firms can absorb the regulations, while smaller, nonintegrated cable systems suffer the dire consequences to their ongoing business operations").

¹⁶ Opposing Telephone Companies claim that the cost of capital expenditures is unsuitable for external treatment because cable operators can decide to reduce their level of capital investment. See, e.g., GTE Opposition at 14. Of course, so too could cable operators simply cut back on their
(continued...)

lingering uncertainty over the manner in which the Commission originally intended to allow systems to recalculate their benchmark-generated rate when undertaking a subsequent upgrade. The shortfall in cash flow to support an upgrade would be mitigated, for instance, if this recalculation incorporated the system's preexisting marginal benchmark, rather than just applying the sharply reduced marginal benchmark corresponding to the system's upgraded channel capacity. Until the Commission reveals its "going forward" forms -- and unless those forms provide for some such benchmark recalculation that would not punish an operator's expansion of channel capacity by slicing its marginal benchmark rate -- some additional mechanism to ensure the recovery of capital investment in regulated cable service remains necessary.

The Cost-of-Service NPRM suggests that the Commission itself is considering somewhat of a continuum of approaches between the alternative poles of a strict "benchmark plus GNP-PI" formula and a full-fledged cost-of-service showing. Among the possible approaches, the external treatment of capital investment could readily be accomplished, at a minimum, at two points along that continuum: first, through a formulaic add-on to the benchmark to cover the costs of an upgrade for regulated cable service; and,

¹⁶(...continued)
programming budget. Yet the Commission recognizes that it is the suppliers of critical inputs -- whether software or hardware -- who determine the cost structure governing cable investment, and thus the Commission already rejected the GTE theory when it established a pass-through for programming costs.

second, through a truncated cost-of-service showing for those undertaking system improvements of a substantially greater magnitude.

A readily calculable, automatic add-on to the benchmark/price cap-generated rate would allow most operators upgrading their regulated cable service to spare both regulators and themselves the burden of a cost-of-service showing. This add-on approach would permit an operator to increase its per-channel rate to the extent necessary to finance the otherwise unrecovered costs of system improvements for regulated cable service.¹⁷ The add-on could be calculated based on the incremental cash flow necessary to support the upgrade, accounting for depreciation and the cost of capital to finance the investment.¹⁸

¹⁷ No one has refuted the substantial benefits of signal quality, system reliability, and channel capacity that optical fiber and related advanced technologies afford to the subscribers of regulated cable service. It is therefore unclear why the Opposing Telephone Companies should now doubt the Commission's ability to decide what portion of such investments should be allocated to regulated cable service. See BellSouth Opposition at 4-6. These are routine questions of rate regulation which the Commission has long answered for telephone companies -- and which the Cost-of-Service NPRM makes plain will have to be answered for cable rate regulation as well. Likewise, NATOA curiously underestimates the ability of the Commission and its own members to recognize an improvement in cable system quality or capacity that would qualify for external cost treatment. See NATOA Opposition at 13-14 and n.15.

¹⁸ See, e.g., Petition for Reconsideration of Comcast Cable Communications, Inc., MM Docket 92-266 (filed June 21, 1993) at 12.

The Commission's announced cost studies, ultimately supplemented by early cost-of-service showings, will provide the Commission with authoritative data from which to establish an appropriate range of upgrade costs permitted under this add-on formula. The cost-of-service rulemaking will also provide the depreciation schedule and cost of capital figures necessary to complete this formula. To avoid completely forestalling cable system improvements until that time, however, the Commission's earliest reconsideration order should adopt this proposal for external treatment of capital investment in regulated cable service -- subject to establishment of the precise formula in its cost-of-service rulemaking.


While this automatic add-on to the benchmark should roughly cover the costs of a typical upgrade or rebuild, the Commission should continue to pursue its proposal for some mechanism -- short of a full cost-of-service showing -- for documenting system improvements of such magnitude that the standard add-on for regulated cable service would be inappropriate. The last of the streamlining alternatives the Commission proposed in the Cost-of-Service NPRM (at ¶ 75) would serve this function precisely, as Corning and Scientific-Atlanta intend to explain further in its comments in that proceeding.¹⁹

¹⁹ Corning and Scientific-Atlanta are seeking to collect, and to provide the Commission in the course of that proceeding, solid data on the range of costs for typical system improvements.

In sum, the record on reconsideration provides ample support for refining the benchmark/price cap mechanism to ensure cable operators recovery of the capital investments necessary to improve regulated cable service. Failure to provide such full recovery -- through the add-on approach suggested above, if not simply by a fair benchmark recalculation -- will either compel widespread reliance on cost-of-service showings or, worse yet, stifle cable investment.

Respectfully submitted,

CORNING INCORPORATED
SCIENTIFIC-ATLANTA, INC.

By: 
Richard E. Wiley
Philip V. Permut
Peter D. Ross
Rosemary C. Harold
of
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

Their Attorneys

August 4, 1993

CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of August, 1993, I caused copies of the foregoing "CORNING INCORPORATED AND SCIENTIFIC-ATLANTA, INC. REPLY TO OPPOSITIONS TO PETITION FOR RECONSIDERATION" to be mailed via first-class postage prepaid mail to the following:

*William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Martin T. McCue
Vice President and General Counsel
United States Telephone Association
900 19th Street, N.W., Suite 800
Washington, D.C. 20006-2105

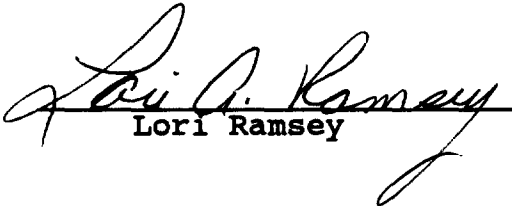
James R. Hobson
Donelan, Cleary, Wood & Maser, P.C.
1275 K Street, N.W., Suite 850
Washington, D.C. 20005-4078
Attorneys for GTE Service Corporation

M. Robert Sutherland
BellSouth Telecommunications, Inc.
4300 Southern Bell Center
675 West Peachtree Street, N.E.
Atlanta, GA 30375

Michael E. Glover
1710 H Street, N.W.
Washington, D.C. 20006
Attorney for The Bell Atlantic Telephone Companies

- 2 -

Norman M. Sinel
Arnold & Porter
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
Attorneys for The National Association of
Telecommunications Officers and Advisors


Lori Ramsey

*Hand Delivery of original and 11 copies